COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts.	D.T.E. 01-20

REPLY BRIEF OF WORLDCOM, INC.
ON RECONSIDERATION ISSUES

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WorldCom, Inc. ("WorldCom") respectfully submits the following reply brief in the reconsideration phase of this proceeding. In this reply brief, WorldCom addresses the principal arguments advanced by Verizon New England ("Verizon") in its initial brief on the four issues on which the Department has sought additional evidence and briefing, pursuant to its September 24, 2002 *Order Granting Verizon and AT&T Motions for Reconsideration, In Part, and Requesting Additional Evidence*. For the reasons set forth below and in WorldCom's Initial Brief, WorldCom urges the Department to:

?? **Reject** Verizon's request to increase switching rates on account of claimed under-recovery of RTU fees, since these costs are already accounted for in its cost study;

?? **Affirm** its finding that a TELRIC cost study should assume 90% new digital switches;

?? **Reduce** the new switch discount consistent with the competitive bid data in the record; and

?? **Reject** Verizon's attempt to increase its claimed costs for DC power cable.

ARGUMENT

I. VERIZON HAS FAILED TO SUBSTANTIATE THE NEED FOR RECOVERY OF INITIAL RTU FEES OVER AND ABOVE THE SWITCH MATERIAL COST PER LINE

Nothing in Verizon's initial brief has changed the fact that Verizon has totally failed to substantiate its claim that a network cost model that assumes 90% new switches must also include a substantial amount of "initial" RTU fees, to the tune of $1.88 million per switch. Verizon argues for the first time in its initial brief that the 90% new switch model must assume that substantial initial RTU fees are incurred on each switch purchase because it must be assumed that no software buyout arrangements are in place, Verizon Brief, pp. 6-7, despite Verizon's claim that its "actual new switching purchases occur in the context of its pre-existing buyout arrangements and ongoing relationships with its switch vendors." Verizon Initial Brief, p. 7. Verizon claims that this purchasing practice explains why there is no "single, readily identifiable, 'initial' RTU fee that the Department can isolate" to quantify initial RTU costs. Id.

Verizon had the opportunity in this phase of the proceeding to estimate initial RTU fees on a per switch basis on the assumption that no software buyout arrangements are in place. Verizon has failed to offer reliable evidence on this point. Lacking evidence to support its "no buy-out" assumption, Verizon is forced to retreat to its Nortel and Lucent "bid" information to substantiate its initial RTU fee estimate of $1.88 million per switch. Yet, Verizon makes no attempt in its initial brief to counter the analysis of AT&T/WorldCom witness Pitts that shows that the claimed initial RTU costs included in the Nortel bids are already included in the per line bid price for the switch purchases cited as evidence by Verizon of its initial RTU costs. Verizon's reliance on the Lucent estimate, Verizon Initial Brief, p. 9, is not persuasive because this estimate was created solely for the purpose of this litigation, is not an estimate based on actual marketplace activity, and thus, cannot be relied on by the Department as evidence of costs.

Even if Verizon is correct that additional costs need to be included in its study (a point which the record does not support), there is no reliable, credible record evidence from Verizon as to what those costs would be a forward looking environment, and there is no evidence showing that this new category of software costs has not already been accounted for in its original cost study. The issue of allocating switch investment between new switches and growth equipment has been litigated in UNE costing cases for several years, yet Verizon has never before asked this Department (or any other state commission) to adjust its software costs depending on the allocation of investment between new switches and growth equipment. Tr., pp. 3727-3728. The reason for this is simple: Verizon's initial RTU costs are, as the record evidence shows, already recovered in the switch material price per line.

The record evidence supports rejecting Verizon's claim of entitlement to a new cost category for initial RTU costs. Verizon, despite ample opportunity to present detailed evidence on this point, has failed to make its case. Its claims should be rejected.

II. VERIZON OFFERS NO COMPELLING REASONS WHY THE DEPARTMENT SHOULD CHANGE THE RATIO OF NEW TO EXISTING SWITCHES

Verizon's initial brief on this issue represents its latest attempt to get the Department to overturn its finding that a TELRIC cost study requires an assumption that the switched network is "dropped in place." Verizon's so-called "life-cycle" analysis, as updated, reflects its findings on what a purchaser of digital switches would expect to buy and pay over the "life cycle" of the switch technology. Specifically, Verizon argues:

> The analysis that Verizon MA set forth in RR-DTE-66 demonstrates the mix of the new and growth switch capacity purchases (50/50) that one could expect to experience for the switches in a network over a significant portion of the technological life of those switches….The net discount created by this purchase mix provides a reasonable estimate of the price structure that a supplier can realistically maintain over the life cycle of a switch technology, whether the equipment is predominantly purchased at the beginning of the life cycle or more evenly spread over the period.

Verizon Initial Brief, p. 12.

This argument clearly demonstrates Verizon's continued attack on the notion that the switching network should be assumed to be "dropped in place," regardless of what might happen in practice in an ILEC's network construction program. The TELRIC methodology requires the Department to assume that all or, as the Department found, nearly all—90%--of the switching investment should be assumed to be for <u>new</u> digital switches (as opposed to growth equipment), which are purchased and installed at the beginning of the study period, not "spread over" the study period, as Verizon's study assumes.

Verizon's "life cycle" analysis is nothing less than an attempt to base Verizon's forward looking switching investment on Verizon's embedded switching investment, by looking at discounts that Verizon was able to negotiate with its switch vendors as far back as 1990. Verizon Exhibit 60-P, p. 12. Verizon argues that “the assumption of a purchasing regime in which all switching equipment is procured in a single transaction with a supplier at the lowest historical cost is inappropriate in a TELRIC study because it defeats the study’s purpose of attempting to establish costs that would be expected to be incurred over the long-run.” Verizon Initial Brief, p. 11. Verizon’s proposed remedy is to go back further in time and get even older historical information, an approach fundamentally at odds with the TELRIC methodology and clearly designed to yield increased costs. Verizon’s approach would have the Department ignore the undisputed observation that prices in the digital switch market have been declining over time and are expected to continue to do so. Tr., pp.3804-3805.

Verizon’s initial brief adds no new arguments in support of its position on this issue. WorldCom urges the Department to reject Verizon’s arguments and to reaffirm its prior holding on this issue.

III. THE RECORD SUPPORTS A PER LINE NEW SWITCH PRICE OF $17.35 FOR NORTEL SWITCHES

Verizon labels the evidence offered by AT&T and WorldCom on new digital switch prices as “fl[ying] in the face of reality.” Verizon Initial Brief, p. 13. Verizon baldly asserts that “[v]endors simply would not, and could not, make available substantial ‘new’ switch discounts if all of their equipment were to be sold at the discount levels reflected in ‘new’ bids.” Verizon Initial Brief, p. 14. Verizon repeatedly relies on “vendor pricing strategy” in support of its argument that Nortel and Lucent would never offer to replace Verizon’s digital switches at the prices contained in recent bids. Yet, Verizon fails to offer any evidence to support that proposition, and fails to offer any testimony from either of its vendors as to what its pricing strategies are. Verizon expects the Department and the parties to accept *Verizon's* view as to what its vendors would do if they had the opportunity to sell a significant number of new digital switches to Verizon. Verizon asserts that "the vast majority of switch vendor revenue from Incumbent Local Exchange Companies is from "growth" equipment sales rather than higher discounted "new" equipment." Verizon Initial Brief, p. 2. Thus, according to Verizon, the prices available for a limited number of new switch purchases today "would not be available in a forward looking environment…." Id. This statement is clearly conjecture on the part of Verizon.

The best evidence available to the Department and the parties as to what Nortel and Lucent would agree to as a sales price is the price at which they are selling (and offering to sell) new digital switches today. Verizon would rather have the Department look at historical price information (again, ignoring the declining cost nature of the market) to establish an estimate of forward looking costs, as opposed to looking at current cost information. Verizon's advocacy is perfectly understandable—it wants to increase costs significantly—but its approach is plainly at odds with what the TELRIC methodology requires. The Department should reverse its adoption of the current Nortel contract price, which the record evidence shows, as observed by AT&T in its brief, to be about five times the price that Verizon actually pays for new digital switches. Instead, the Department should base its estimate of the price of new digital switches on unrebutted record evidence as to what Verizon is actually paying today for new digital switches, contained in the proprietary attachment to RR-DTE-49S.

IV. VERIZON HAS ONCE AGAIN FAILED TO EXPLAIN THE ERROR IN ITS PRESENTATION OF ITS AVERAGE CABLE LENTHS

Over the objections of other parties, the Department permitted Verizon to correct the record in this proceeding on its average collocation cable lengths, despite Verizon's admission that the error was made by Verizon in making its direct case. Reconsideration Order, p. 13. Having been given another chance to supplement the record to explain why the average should be 121 feet as opposed to its original claim of 60.5 feet, Verizon failed to present any evidence in direct testimony on this issue. On brief, Verizon has failed to offer any legal or factual argument to explain the error and clarify the record. Although the record supports a lower average cable length than found by the Department, based on the testimony of AT&T/WorldCom witness Turner, the Department should not give further consideration to modifying its finding in favor of Verizon in light of its complete failure to offer any evidence or further argument on the data that it submitted in its original cost study. Verizon's request for modification of the July 11, 2002 Order should be summarily rejected.

CONCLUSION

For the reasons set forth above and in WorldCom's Initial Brief, WorldCom urges the Department to 1) reject Verizon's request to increase switching rates on account of claimed under-recovery of initial RTU fees, since these costs are already accounted for in its cost study; 2) affirm its finding that a TELRIC cost study should assume 90% new switches; 3) reduce the new switch discount consistent with the competitive bid data in the record; and 4) reject Verizon's attempt to increase its claimed costs for DC power cable.

Respectfully submitted,

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